

Masters of Science (Banking)

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WBB 6013: SEMINAR IN BANKING

Incidences of New Bad Cheque Offenders and KLCI  
Performance: 1996 – 2007 Analysis

By

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**Abstract**

This paper explores the relationship between incidences of new bad cheque offenders (NBCO) and the Kuala Lumpur Composite Index (KLCI) performance in Malaysia for the period 1996 – 2007 using descriptive and correlation analysis. It is perceived that NBCO would increase when KLCI performance falls. The empirical testing results provide a high negative correlation between NBCO and KLCI.

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*Keywords:* bad cheque offender

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## **1. INTRODUCTION**

Cheques are widely used by Malaysians as a convenient mode or mean for making payments either for personal or business transactions. However the cheques may be returned by the drawee bank due to insufficient funds in the account, effect not cleared i.e. cheques deposited but funds are not yet available for use by accountholder or the accountholder's current account has been closed. Such cheques are commonly referred to as "bad" cheques or also known as dishonoured cheques, NSF cheques, bounced cheques, rubber cheques, bogus cheques, etc. These "bad" cheques can impede the widespread use and acceptance of cheques by our society. It may pose serious problem to an individual or for any size company. For this unlawful act, the redress / remedies are civil and criminal penalties although it is much more costly and difficult to prove a criminal case. Different countries adopt different measures. In certain countries, it is a criminal offence to issue dishonoured cheque and can result in imprisonment. It can also have a serious consequence on the drawer ability to operate the current account with the continuous issuance of "bad" cheques and have a negative impact on loan sanction.

In Malaysian context, a "bad" cheque offender is defined as a person who issued three cheques which were returned unpaid due to insufficient funds or 'effects not cleared' within a period of 12 months. From 15 June 2005 onwards, it refers to accounts closed by banks due to frequent issuance of dishonoured cheques due to insufficient funds with a minimum of three issuances within a period of 12 months.

The internationally accepted definition of a cheque according to Bank of International Settlement is "a written order from one party (the drawer) to another (the drawee, normally a bank) requiring the drawee to pay a specified sum on demand to the drawer or to a third party specified by the drawer".

## **2. LITERATURE REVIEW**

Issuance of “bad” cheques can create problems and also tarnish the reputation or cause loss of creditworthiness to the drawer. The account holder on issuing three “bad” cheques over a 12-month period will not be allowed to operate a current account in Malaysia for a specified period of 6 months to 24 months depending on the level of offence committed. Relationship between the issuer (drawer) and recipient (beneficiary) of the cheque may be affected by a “bad” cheque. It may result to a loss of a business deal because of a loss of trust between the issuer and the payee. The credibility of cheques as a mode of payment in Malaysia will be seriously affected. Despite the imposition of penalties by banks, it has not deterred some account holders from issuing “bad” cheques. Previously the drawer can go to another bank to open new current account even after the “bad” cheque account has closed because of the absence of a central bureau.

### **2.1 Bank Negara Malaysia and Cheques**

Many years ago the incidences of cheques dishonoured due to insufficient funds was alarming. To control this unhealthy situation, the Association of Banks in Malaysia (ABM), in consultation with Bank Negara Malaysia (BNM) look into effective measures to deal with the problem. As a result, Biro Maklumat Cek (BMC) was established in 1988 by BNM as a central bureau to monitor “bad” cheque issuers and also to promote the use of cheques as an acceptable mode of payment. To address the issuance of “bad” cheques and standardised practice among the banks, the “Biro Maklumat Cek Operational Framework and Reporting Guidelines” were issued by BNM. In March 2002, consistent with the amendments to the Central Bank of Malaysia Act 1958, BNM consolidated the operations of the BMC with the Credit Bureau, which is a bureau set up to collect and disseminate credit information including information on “bad” cheques to banking institutions and other financial institutions.

## 2.2 What constitute a “Bad” Cheque?

Under the BMC guidelines, a “bad” cheque means a cheque issued by an accountholder, which has been dishonoured and returned by the drawee bank for the following reasons:

- a. there are insufficient in the account in which the cheque is drawn;
- b. a cheque issued for which the funds were not available for use by the accountholder (known as “Effects Not Cleared”); or
- c. a cheque issued on an account which has been closed for reasons other than being closed due to bankruptcy or the account has been frozen arising from a Court Order.

With regards to item (c), the closed account e.g. account closed voluntarily will be monitored by the drawee bank for a 12-month period from the date the account is closed. Should three “bad” cheques be issued during the period, the account will be reported to the Credit Bureau through the BMC System.

## 2.3 Bad Cheque Offender

Each “bad” cheque issued is treated as one “bad” cheque incident. A warning letter from the drawee bank will be issued for each “bad” cheque incident. If three “bad” cheque incidents are committed on the same account over a 12-month period, the person will be deemed as a “bad” cheque offender and as a result:

- The current account will be closed and the person’s name will be reported to the Credit Bureau by the drawee bank
- The person’s name will be included in the list of “bad” cheque offenders and will be circulated to all banks in the country. When the banks receive the list from the Credit Bureau, all the person’s other current accounts maintained with the banks will be closed within one month (referred to as Nationwide or Global Closure).
- The person will be required to return all unused cheques to the bank(s).

- The person will be subject to a prohibition period, whereby the person will not be allowed to open or operate any current account with any bank in Malaysia.
- In addition, the person will also be subjected to a probation period on expiry of the prohibition period.

#### **2.4 Guidelines on Dishonoured Cheques Information System (DCHEQS)**

Effective from 15/06/2005, Bank Negara Malaysia has replaced its 1999 BMC Operational Framework and Reporting Guidelines with 'Guidelines on Dishonoured Cheques Information System (DCHEQS). With the introduction of the guidelines, the existing requirements for global closure of current accounts of bad cheque offenders have been abolished. Instead licensed banks would have the discretion to close or maintain customer's current account at its own bank. The DCHEQS is a computerised database system developed and maintained by BNM to collect, process, store and generate information related to dishonoured cheques.

#### **2.5 Kuala Lumpur Composite Index (KLCI)**

KLCI is the proxy for stock market performance. Its objectives are to:

- a. To provide a performance benchmark for the Malaysian equity market.
- b. To reflect the performance of listed companies that are representative of the major sectors as in the Malaysian economy.
- c. To reflect growth and development in Malaysian corporate and economic sector.

The past performance of KLCI from 1996 – 2007 is depicted in Table 1 below. KLCI registered its lowest level during the financial crisis from 1997 to 1998 or highest negative % growth of 51.98% in 1997. Kuala Lumpur Stock Exchange (KLSE) which had been the third largest stock exchange in the region after Tokyo and Hong Kong, fell precipitously from 1,077.3 points in June 1997 to 262.7 points on September 1, 1997. On the whole, between July 1, 1997 and September 1, 1998, market

capitalization of KLSE fell by 76% to RM181.5 billion. Before long, the impact of the financial crisis was being felt as evidenced by business closures, retrenchments leading to high unemployment and increasing inflation. For the first time since 1985, the Malaysian economy experienced a recession contracting 6.7 per cent in 1998. The downturn is worse than that experienced by the country since 1985.

KLCI was at its highest level in 2007. Highest KLCI % growth was recorded in 1999 at 38.59% which correspondingly its returns from KLCI based on KLCI average daily index at 34.30% was second highest compared to the highest of 37.10% in 2007. A more reflective KLCI positive or negative growth would be the returns based on average daily index for the year.

Table 1 : KLCI Performance

<i>Period</i>	<b>KLCI – Composite Index</b>	<b><i>KLCI</i> % <i>growth</i></b>	<b>Returns from KLCI based on KLCI avg daily index for the year</b>
	<b>(KLCI)</b>	<b>(KLCI%)</b>	<b>(KLCI%Ret)</b>
1996	1237.96		15.20%
1997	594.44	-51.98%	-14.20%
1998	586.13	-1.40%	-47.10%
1999	812.33	38.59%	34.30%
2000	679.64	-16.33%	-7.50%
2001	696.09	2.42%	-0.50%
2002	646.32	-7.15%	12.10%
2003	793.94	22.84%	2.10%
2004	907.43	14.29%	17.80%
2005	899.79	-0.84%	5.10%
2006	1096.24	21.83%	5.80%
2007	1445.03	31.82%	37.10%

Source : Bursa Malaysia

### 3. RESEARCH METHODOLOGY

In this study, we attempt to establish the correlation between the incidences of new bad cheque offenders (NBCO) and Kuala Lumpur Composite Index (KLCI) performance in Malaysia. The dependent variable is the new bad cheque offenders whereas the independent variable is KLCI being the proxy of stock market performance. The moderating variables are the volume and value (RM) of cheques cleared. These variables, together with the expected relationship with new bad cheque offenders are as follow:

Independent / Moderating Variables	Movement	Expected Relationship
1. KLCI	Decrease	Negative (-)
2. Volume of Cheques Cleared	Increase	Positive (+)
3. Value of Cheques Cleared	Increase	Positive (+)

### 4. HYPOTHESIS DEVELOPMENT

We hypothesized that the number of new bad cheque offenders (NBCO) would increase when the KLCI is decreasing and vice versa.

On the moderating factors, the number of NBCO would increase with the increase in volume and value of cheques cleared.

#### 4.1 Data and Analysis

The secondary data were sourced from BNM, Bursa Malaysia and The Statistical Dept for the period 1996 to 2007. The start year 1996 was taken as the number and value of clearing cheques were not available earlier. 2007 was taken as the end of the study period due to non completion of the current calendar year.



Table 2 below depicts the annual number of new bad cheque offenders and the cheques (both in volume and value) for the period 1996 – 2007 and the KLCI as at end of the respective year under review.

Table 2 : No. of New Bad Cheque Offenders, Cheques Cleared and KLCI

Period	No. of new bad cheque offenders	Cheques cleared		KLCI – Composite Index as at 31 December	Returns from KLCI based on KLCI avg for the year
	No.	No. (million)	RM billion		
	NBCO	(Chq)	(Chq\$)	KLCI	(KLCI% Ret)
<b>1996</b>	50197	96.1	1109.9	1237.96	15.2%
<b>1997</b>	66441	104.8	1304.7	594.44	-14.20%
<b>1998</b>	87780	133.2	954.1	586.13	-47.10%
<b>1999</b>	64594	154.1	1041.9	812.33	34.30%
<b>2000</b>	57301	164.8	1076.0	679.64	-7.50%
<b>2001</b>	67860	166.7	1004.4	696.09	-0.50%
<b>2002</b>	74146	176.4	1081.4	646.32	12.10%
<b>2003</b>	74194	179.9	1144.0	793.94	2.10%
<b>2004</b>	70465	183.8	1226.9	907.43	17.80%
<b>2005</b>	57316	184.8	1234.8	899.79	5.10%
<b>2006</b>	36555	186.3	1315.3	1096.24	5.80%
<b>2007</b>	30004	192.4	1546.6	1445.03	37.10%

Source : BNM & Bursa Malaysia

Based on statistical data analysis (Chart 1, 2 ,3 & 4 below), we found that the NBCO increased to the peak during the financial crisis period from 1997 to 1998 where the KLCI recorded the lowest during the period under review and recovered thereafter.

The NBCO was on the rise again during the period 2002 – 2004 where KLCI recorded the second downtrend during the period under review. Thereafter the incidence of

NBCO has been on the decreasing trends especially during the 2006 – 2007 where KLCI recorded an increasing trend.

Chart 1 – No. of New Bad Cheque Offenders

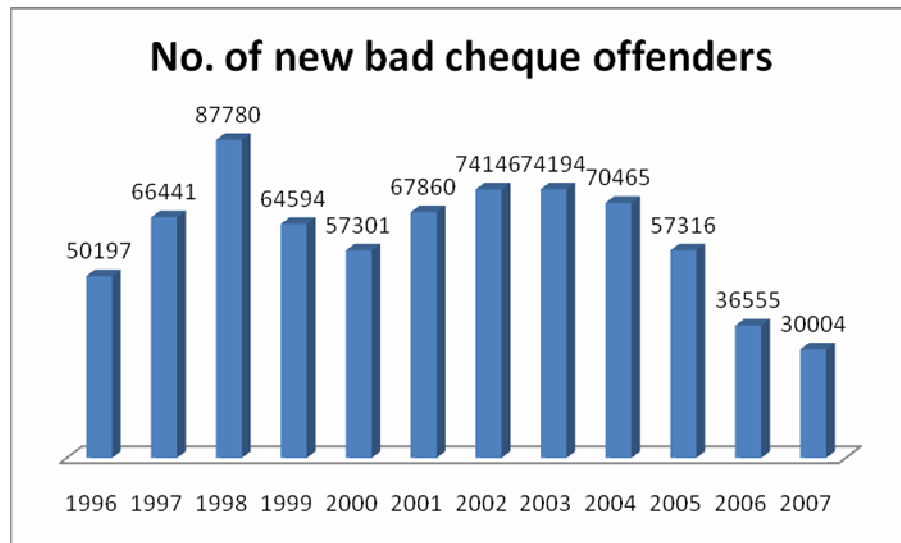


Chart 2 – KLCI Performance

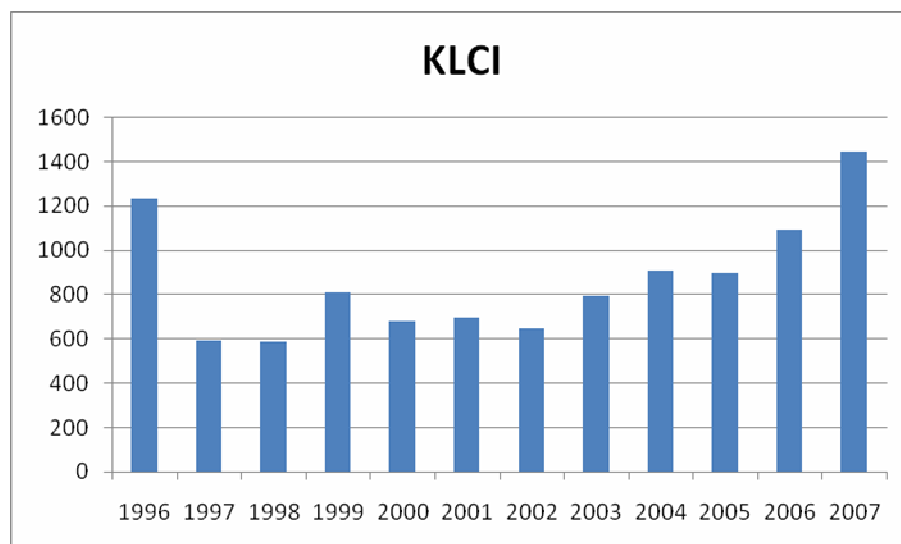


Chart 3 – No. of New Bad Cheque Offenders

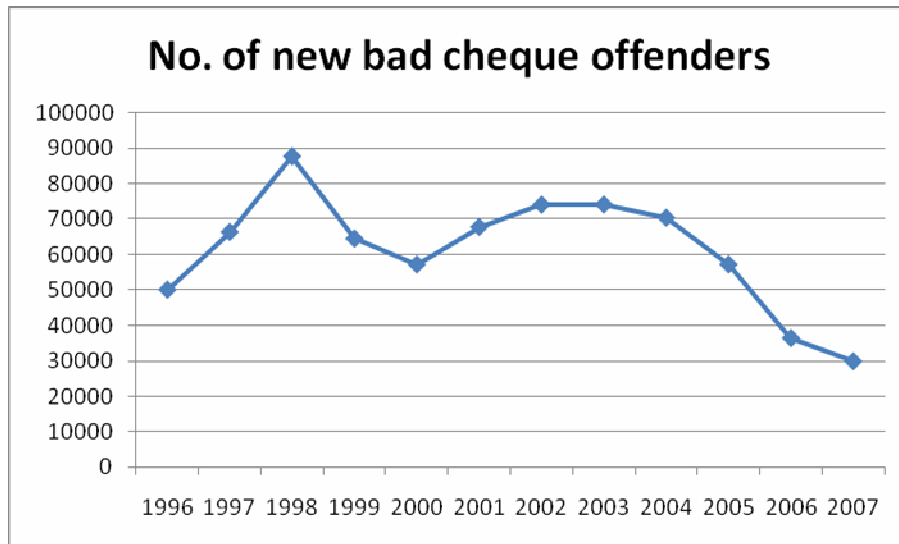
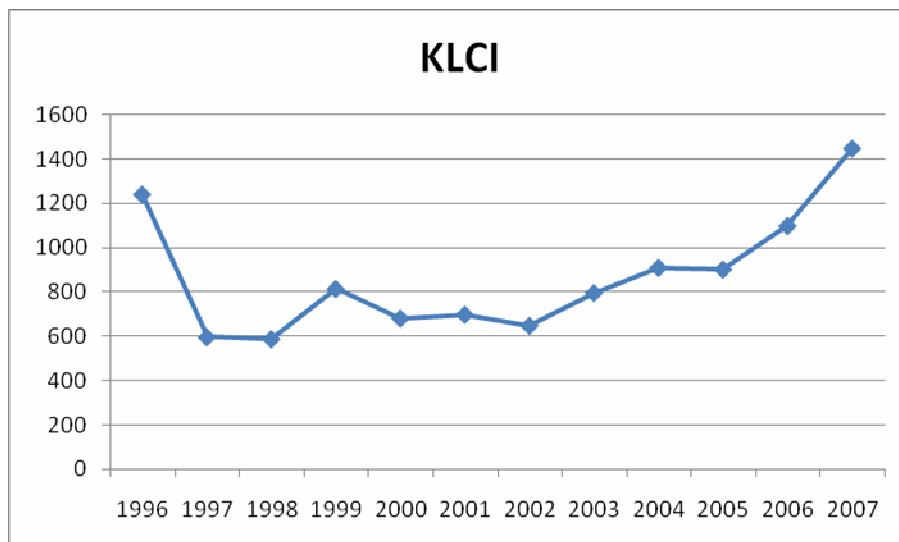


Chart 4 – KLCI Performance



This is consistent with the hypothesis that the incidences of NBCO would increase when KLCI performance falls. However, in order to confirm this inverse relationship, an empirical study would need to be carried out to test this hypothesis.

#### 4.2 Correlation Testing, Results and Discussion

SPSS was used to run the correlation based on the data and outputs were as below:-

Correlations			
		No. of new bad cheque	KLCI
No. of new bad cheque	Pearson Correlation	1	-.840**
	Sig. (2-tailed)		.001
	N	12	12
KLCI	Pearson Correlation	-.840**	1
	Sig. (2-tailed)	.001	
	N	12	12

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Based on the above results, there is a strong negative correlation between NBCO and KLCI of -0.84 at 1% significant level. In other words, there is a possible inverse linear relationship between NBCO and KLCI.

Similar correlation analysis performed between NBCO and the No. of Cheques Cleared (NOCC) however indicated there is no significant linear relationship among these two variables at 1% significant level.

On the other hand, the correlation analysis between NBCO and Value of Cheques Cleared (VOCC) registered a significant correlation of -0.74 in the opposite direction as depicted in the table below at 1% significant level:

**Correlations**

		No. of new bad cheque	Value of Cheques cleared
No. of new bad cheque	Pearson Correlation	1	-.743**
	Sig. (2-tailed)		.006
	N	12	12
Value of Cheques cleared	Pearson Correlation	-.743**	1
	Sig. (2-tailed)	.006	
	N	12	12

\*\* . Correlation is significant at the 0.01 level (2-tailed).

However, this negative correlation is not in line with the expected relationship between NBCO and VOCC. There are a number of explanations that can be accorded to support this inverse relationship. Firstly, owing to minimum observation (only 12), the statistical results would not reflect the actual findings. Perhaps a quarterly or monthly data set would address this limitation.

## 5. CONCLUSION

As such we conclude that the correlation analysis provides a high negative correlation between NBCO and KLCI.

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